

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Cardenas Analyst: Darrine Distefano Bill Number: AB 1257
Related Bills: See Legislative History Telephone: 845-6458 Amended Date: April 26, 2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Care Facility Credit/50% of Cost for Low-Income Facilities/Bank Loan Credit/FTB to Report to Legislature

SUMMARY

This bill would allow:

- A credit for contributions for building or expanding a child care facility.
- A credit for banks and financial institutions for interest income earned on loans made for building or expanding a child care facility.

This bill would require the Franchise Tax Board (FTB) to report on the interest income credit upon request by the Legislature.

Each provision will be discussed separately in this analysis.

SUMMARY OF AMENDMENTS

The April 26, 2001, amendments changed the effective and operative dates for each provision and added several co-authors to the bill.

Under the child care facility credit provisions, the April 26th amendments:

- Revise the definition of a “qualified care facility.”
- Require the child care provider to provide information to the taxpayer and the Department of Social Services (DSS).
- Require DSS to certify specific terms for the taxpayer to claim the credit.
- Require DSS to provide specific information to FTB, and
- Add a recapture provision.

Under the interest income provision, the April 26th amendments:

- Revise the definition of “qualified amount.”
- Revise the definition of a “qualified care facility.”
- Add the terms and define “construct” and “expand.”
- Add a \$5 million limitation on the credit for each taxpayer.
- Delete the provision that allows a bank or financial corporation to transfer or sell the loan to another bank or financial corporation and retain the credit.

This is the department’s first analysis of this bill.

Board Position:

| | | |
|----------|-----------|-----------------|
| _____ S | _____ NA | _____ NP |
| _____ SA | _____ O | _____ NAR |
| _____ N | _____ OUA | _____ X PENDING |

Department Director

Date

Gerald H. Goldberg

05/25/01

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to expand the capacity for child care facilities in low-income areas.

POSITION

Pending.

1. CHILD CARE FACILITY CREDIT

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would be operative for taxable years beginning on or after January 1, 2002, and before January 1, 2007.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law does not currently offer any child care facility credit similar to the credit in this bill.

Existing state law allows employers a tax credit known as the Employer Child Care Program Credit. This credit equals 30% of the costs for (1) establishing a child care program or constructing a child care facility in California to be used by employees' children and (2) contributing to child care information and referral services. Building owners are allowed a credit equal to 30% of their costs to establish a child care program or facility to be used by their tenants' employees' children. The amount of the credit is limited to \$50,000. To the extent that the allowed credit cannot be used, the credit may be carried over. The carryover amount may be added to any credit for that succeeding year, which is still limited to \$50,000.

Existing state law also allows employers a tax credit known as the Employer Child Care Contribution Credit. This credit equals 30% of the costs for contributing to a child care program for the employees' dependents. The credit is limited to \$360 for each dependent under the age of 12.

THIS BILL

This bill would allow a credit equal to 50% of qualified expenditures for monetary contributions in excess of \$4,000 for constructing or expanding a qualified child care facility located in California.

This bill would define "qualified expenditures" to include only monetary contributions made by a qualified taxpayer that do not exceed either \$400,000 for any single qualified child care facility or \$2 million in aggregate contributions for multiple qualified child care facilities. The \$400,000 and \$2 million maximums are cumulative and include amounts contributed in prior taxable years. The maximums also would include qualified expenditures made by any party related (as defined by federal law) to the taxpayer. Expenditures over the \$400,000 or \$2 million limits cannot be taken into account in computing this credit in any subsequent taxable year.

This bill would provide that a taxpayer could not utilize more than \$150,000 of the credit in any single taxable year. If the credit exceeds the \$150,000 annual limitation or exceeds the taxpayer's tax liability, any excess credit may be carried over for six succeeding years and applied on a "first-in, first-out" basis. The aggregate "allowable child care facility credit" for each taxpayer and any party related to the taxpayer for the taxable years the credit is authorized cannot exceed \$1 million.

A "qualified care facility" is defined as either of the following:

- Any newly constructed licensed child care facility located in California. This excludes licensed family child care homes or license-exempt care.
- Any expanded existing child care facility or licensed family child care home located in California. This excludes licensed-exempt care.

A qualified child care provider would be required to submit the following information to the qualified taxpayer and the DSS:

- The child care provider's tax identification number.
- A written plan that reflects the child care provider's ability to recruit children from low-income families.
- A statement certifying that the facility will be operated as a child care facility for a minimum of five years.
- An agreement signed by the qualified child care provider stating that the monetary contributions received from the qualified taxpayer will be used to construct or expand a child care facility in California.
- A receipt identifying the amount of any monetary contributions received by the qualified taxpayer.
- An agreement that both of the following will be completed within a one-year period beginning on the day the expenditures are paid by the qualified taxpayer:
 - The construction or expansion and beginning of operation of the child care facility.
 - The child care provider will obtain approval to accept children from families qualifying for child care subsidies if the child care facility is not geographically located within one mile of a low-income area, as defined by the amended Community Reinvestment Act of 1977.

The bill would define "construct" or "expand" to include feasibility studies, site preparation, construction, renovation, or acquisition of facilities for purposes of establishing a new licensed child care facility or expanding an existing licensed child care facility that adds new child care capacity.

The term "low-income families" means households that have incomes below 75% of the local area median income, as published by the U.S. Department of Housing and Urban Development or as defined in regulations issued by the State Department of Education.

"Child care provider" is defined as the licensed owner or operator receiving the benefit of any cost paid, incurred, or contributed and claimed by a taxpayer. A child care provider is ineligible for the credit.

A deduction would not be allowed for the portion of the qualified expenditures equal to the credit. Additionally, no credit would be allowed to a taxpayer that is required by a local ordinance or regulation to provide a child care facility.

This bill would require the taxpayer to recapture the credit if the qualified child care facility is not operated for 24 consecutive months as a child care facility. The credit would be recaptured in the year the qualified child care facility ceased operation as a child care facility. Thus, the facility could be sold and if it continued to be operated as a child care facility, the credit would not be subject to recapture. The bill also would suspend the 24 month requirement for any period during which the child care provider suspends child care services in order to replace the property as a result of an involuntary conversion, as described in federal law. Under that federal law, taxpayers generally have up to two years to replace property compulsorily or involuntarily converted due to destruction (in whole or in part), theft, seizure, requisition or condemnation.

The bill would provide that no credit would be allowed for a child care facility unless DSS provides certification. Within a one-year period from the date the taxpayer makes a qualified expenditure to a qualified child care provider, DSS must:

- Certify that the taxpayer's monetary contribution was used to construct or expand a qualified child care facility.
- Certify that the qualified child care provider has received approval to accept children from low-income families or the facility is geographically located in or within one mile of a low-income area, as defined by the amended Community Reinvestment Act of 1977.
- Certify that the qualified child care facility began operating as a child care facility.

On an annual basis for six years, DSS must also certify the number of months the qualified child care facility operated as a child care facility.

DSS would be required to provide an annual listing to FTB of the following:

- Taxpayers making monetary contributions during the previous calendar year, the taxpayer's name, taxpayer identification number, and the date and amount of monetary contributions made.
- Child care providers receiving monetary contributions during the six preceding calendar years, the qualified child care provider's taxpayer identification number, and the number of months the qualified child care facility was operated as a child care facility.
- The information contained in DSS' certifications as described above.

This bill also would include the proposed Child Care Facility Credit in the list of credits that can reduce regular tax below tentative minimum tax for purposes of the alternative minimum tax calculation.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

There are a substantial number of undefined terms, technical problems, and ambiguous words used throughout the bill. For example, the bill defines "child care provider" but repeatedly uses the term "qualified child care provider," which is undefined. Similarly, the term "child care facility" is used but the term defined is "qualified care facility."

DSS would be required to certify several items concerning the credit. DSS would not be required to certify the taxpayer's "qualified expenditures" made to the child care provider and would not be required to calculate the credit.

DSS only would be required to certify that the monetary contribution received by the child care provider was used to construct or expand a child care facility. DSS also needs to certify the taxpayer's qualified expenditures.

This bill would require the taxpayer to recapture the credit if the facility is no longer operated as a child care facility. This provision may be difficult to verify since the department would be auditing the taxpayer, not the child care facility. Also, this provision would penalize the taxpayer for circumstances that are out of its control. The taxpayer should recapture the credit if the facility is sold, even if the new buyer continues to operate it as a child care facility.

LEGISLATIVE HISTORY

SB 549 (Ortiz, 1999/2000) proposed to expand the existing Child Care Program Credit to include taxpayers that contribute costs for low-income facilities. AB 401 (Strickland, 1999/2000) proposed to remove the sunset date of the Employer Child Care Contribution Credit and to allow a credit for child care expenses. Both of these bills failed to pass out of the first house by January 31 of the second year of the session

AB 1923 (Cardenas, 1999/2000) and SB 1661 (Solis, 1999/2000) contained language similar to the child care facility credit in this bill. AB 1923 died in Assembly Appropriations, and SB 1661 was dropped by the author.

OTHER STATES' INFORMATION

Review of *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws found no comparable tax credits or deductions.

Florida allows a Child Care Credit for corporations to apply against corporate income tax or insurance premium tax, but not both. There are three components to the credit:

- (1) A credit for no more than 50% of the start up costs for a child care facility;
- (2) A credit of \$50 per month for each child enrolled in a child care facility operated on behalf of its employees; and
- (3) A credit of 50% for direct payments made by a corporation to a child care facility.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Once the implementation concerns are resolved, this provision would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would result in revenue losses as shown in the following table:

| Estimated Revenue Impact | | | |
|---|--------|--------|--------|
| Taxable Years Beginning On or After January 1, 2002 | | | |
| Fiscal Years | | | |
| (In Millions) | | | |
| | 2002-3 | 2003-4 | 2004-5 |
| Facility Credit | -\$1.0 | -\$1.2 | -\$1.3 |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

Facility Credit:

Revenue losses would depend on the amount of new cash contributions and redirected cash contributions of at least \$4,000 per contributor. For purposes of this estimate, it is assumed that contributions will be redirections of amounts usually given to other organizations that are deductible for income tax purposes, or trade or business expenses for employers making contributions for the benefit of employees.

The number of child care centers qualifying under this provision is projected to be 95% of the total new or expanded non-government, for-profit centers in California, i.e., 655 centers in 2002. The growth rate for centers increases from 4% in 1998 to a projected 8% in 2003 and thereafter due to factors such as welfare reform, increased funding from the California Department of Education, the increasing demand for child care in California, and the incentive effect of this provision. These factors were also considered in the estimate for centers that will expand existing facilities.

Of the projected 655 new or expanded qualified child care facilities in 2002, it is assumed that 25%, or 164 facilities, will receive two cash contributions averaging \$5,000. The total projected 2002 contribution after the 50% credit limitation is approximately \$1.2 million. The 2002 offset is projected to be approximately \$200,000 resulting in a projected 2002 revenue loss of \$1 million.

Estimates were developed in coordination with child care system and facility experts at the National Economic Development and Law Center and the California Child Care Resource and Referral Network.

2. INTEREST INCOME CREDIT ON CHILD CARE FACILITIES

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. This credit would be operative for taxable years beginning on or after January 1, 2002, and before January 1, 2012.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law provides that interest on federal obligations (e.g., bonds issued by the federal government) is taxable by the federal government but nontaxable by the states. Federal law allows the imposition of a state franchise tax on that interest only if the state franchise tax is nondiscriminatory. (The tax imposed on the federal interest cannot be different than the tax assessed on other types of interest.)

Under existing state law, interest on state or local obligations (e.g., bonds issued by a state or political subdivision thereof) and interest on federal obligations are exempt from personal and corporate income tax but are included within the measure of the corporate franchise tax.

Existing state law allows a credit for interest income on loans used to finance qualified expenditures for farmworker housing. Existing state law also allows taxpayers that make loans to businesses within an enterprise zone to deduct net interest.

THIS BILL

This bill would allow a credit of 25% of the interest income earned on loans used to finance expenditures paid or incurred to construct or expand a qualified child care facility.

The credit would not apply to loans with a term of less than three years or to loans funded prior to January 1, 2002. The credit would apply only to interest income from the loan and would not apply to any other loan fees or other charges collected by the bank or financial corporation with respect to the loan.

The amount of credit under this proposed section could not exceed \$5 million dollars for each bank or financial corporation per taxable year.

"Qualified care facility" is defined as either of the following:

- Any newly constructed licensed child care facility located in California. This excludes licensed family child care homes or license-exempt care.
- Any expanded existing child care facility or licensed family child care home located in California. This excludes licensed-exempt care.

A qualified child care facility must meet both of the following requirements:

- Is operated by child care providers that make an agreement with the bank or financial institution to provide child care services for the entire term of the loan.
- Meets one of the following requirements:
 - Is located in low- or moderate-income areas, as defined by the Community Reinvestment Act of 1977 (Public Law 95-128), as amended; or
 - Is operated by child care providers that make an agreement with the bank or financial institution lender that not less than 30% of the children served by the facility will be from households with incomes at or below 75% of the local median income as published by the Department of Housing and Urban Development.

The bill would define "construct" or "expand" to include, but not be limited to, feasibility studies, site preparation, construction, renovation, or acquisition of facilities for purposes of establishing a new licensed child care facility or expanding an existing licensed child care facility that adds new child care capacity.

This credit would not apply to loans for purchasing land or for refinancing existing loans.

The credit would be disallowed for any year after the occurrence of a disallowing event. A disallowing event occurs if the child care provider: 1) defaults on the loan agreement for more than 90 days, 2) ceases providing child care in the facility for which the loan was made for more than 90 days, or 3) ceases providing child care services based on the agreement to have no less than 30% of the children served be from households with incomes at or below 75% of the local median income.

FTB would be required to report to the Legislature, upon request, the total amount of tax credits claimed under this provision, and the number, type, and income level of taxpayers claiming the credits. To the extent the information is available, FTB also would be required to report the industry classification of corporate taxpayers claiming the credits.

IMPLEMENTATION CONSIDERATIONS

The bill provides a credit for interest received on loans used to finance the construction or expansion of a qualified child care facility. Although the qualified child care facility must be operated by a licensed child care provider that covenants to a bank or financial institution to provide child care services, the bill does not clearly limit the credit to loans made to child care providers.

The bill would disallow the credit based upon the occurrence of certain future behavior of the borrower or, if the borrower is not a child care provider, someone other than the borrower. The occurrence of a disallowing event would be extremely difficult to determine because neither the taxpayer nor the bank have to provide any substantiation that a disallowing event has occurred. Also, the disallowance language mentions an "installment" of credit. This reference reflects the original bill, which required the credit to be claimed in installments and should be updated to eliminate this term.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credits to the interest credit. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Once the implementation concerns are resolved, this provision would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would result in revenue losses as shown in the following table:

| Estimated Revenue Impact | | | |
|---|--------|--------|--------|
| Taxable Years Beginning On or After January 1, 2002 | | | |
| Fiscal Years | | | |
| (In Millions) | | | |
| | 2002-3 | 2003-4 | 2004-5 |
| Interest Income Credit | -\$2.0 | -\$4.0 | -\$6.0 |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

This bill would allow a credit of 25% of the interest income earned by a bank or financial corporation on loans used to finance expenditures actually paid or incurred to construct or expand a qualified child care facility. The bill does not require lenders to provide a discounted interest rate or to base the credit on the amount of interest foregone. The 25% credit is projected to create larger revenue losses because of the larger interest amounts involved and the inherent incentive effect to lenders. As a rule of thumb, the projected revenue losses assume that \$100 million in loans will qualify annually and that the average commercial interest rate will be 8%.

POLICY CONCERNS

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations for interest earned on loans relating to child care facilities, thereby arguably favoring such loans over federal obligations. Thus this credit, without a comparable credit counterpart for federal obligations, could be seen as making state franchise tax discriminatory in violation of federal law.

This credit could not be carried over if the taxpayer does not use the entire credit amount in the year claimed. The carryover language appears to have been inadvertently removed by the April 26 amendments. The author may wish to add language allowing a limited carryover period.

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